No. 13116.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PALOS VERDES CORPORATION,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the United States District Court for the Southern District of California.

BRIEF FOR THE UNITED STATES.

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Opinion Below.

The findings of fact and conclusions of law of the District Court [R. 60-69] are not officially reported.

Jurisdiction.

This appeal involves a claim for refund of corporation income and declared value excess profits taxes for the fiscal year ended September 30, 1944, in the amount of $5,467.88, which sum it had paid when its return was filed on December 15, 1944. [R. 5.] Taxpayer filed a claim for refund on May 9, 1945, and again on October 30, 1946 [R. 17-18, 35-43], on the ground that it had erroneously reported a profit from the sale of unsubdivided land as normal tax net income rather than as net

gain from the sale or exchange of capital assets. The Commissioner disallowed the claim on August 4, 1949. [R. 18, 43-44.] Within the time provided in Section 3772, Internal Revenue Code, and on April 11, 1950, taxpayer filed a complaint in the District Court for the Southern District of California for refund of the alleged overpayment. [R. 3-14.] Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346(a)(1). Judgment was entered in favor of the United States on July 10, 1951. [R. 69-70.] Within 60 days and on July 28, 1951, notice of appeal was filed. [R. 71.] Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Whether profit received by taxpayer from the sale of a parcel of land was taxable as ordinary income or as capital gain under either Section 117(a) or (j), Internal Revenue Code.

Statute and Regulations Involved.

The pertinent provisions of the Internal Revenue Code and Treasury Regulations involved are printed in the Appendix, *infra.*

Statement.

The facts as stipulated by the parties [R. 17-59] and as contained in the findings of fact of the District Court [R. 60-68] may be summarized as follows:

Taxpayer is a corporation organized November 27, 1925, under the laws of the State of Delaware with its principal office and place of business located in the City of Wilmington, County of Newcastle, Delaware. Since 1926,

taxpayer has transacted and is doing business in the County of Los Angeles, State of California. Taxpayer took over from Palos Verdes Syndicate as of January 1, 1926, approximately 12,245 acres of land in the County of Los Angeles, State of California, with other assets, giving in exchange therefor 54,000 shares of its common stock having an aggregate par value of 5,400,000, issued *pro rata* to the members of the syndicate as their interests appeared. This land was known as "Rancho Palos Verdes." [R. 18, 62-63.]

"Rancho Palos Verdes" originally comprised approximately 16,004 acres of unimproved real property in the County of Los Angeles. It was acquired by a group of persons known as the Palos Verdes Syndicate in the year 1913. It consists of very little level land. It rises from the ocean to an elevation of some 1,400 feet in a matter of possibly two or two and one-half miles, and slopes down again to the plains on the inland side. Some of it is suitable for farming, and some of it is made of arroyos and precipitous parcels that are not available for farming. After acquisition, the Palos Verdes Syndicate appointed a general manager to operate and manage the Rancho, and it engaged in incidental farming activities. After holding the land for a period of ten years, the Palos Verdes Syndicate decided to sell the whole parcel, and entered into an agreement to sell in the year 1923. The whole sale was not consummated by reason of the fact that the purchaser was unable to raise sufficient monies to buy the whole rancho. Two portions of the rancho were actually sold, to wit: 3,000 acres in the northerly and westerly edges of the Rancho, and 200 acres on the southerly and easterly edges of the Rancho, and this land was deeded to the Bank of Italy, in trust, for subdivision

and development purposes. These portions were later subdivided and developed and handled by the Bank of Italy and became known as "Palos Verdes Estates" and "Miraleste," respectively. Neither the Palos Verdes Corporation nor the Palos Verdes Syndicate had any further interest therein from the date of sale. [R. 63-64.]

In the month of July, 1944, taxpayer sold to one Snow an unsubdivided portion of taxpayer's real property in the County of Los Angeles, State of California, for the sum of $90,000, consisting of 422.56 acres. This real property has a cost basis to taxpayer in the sum of $23,636.93, resulting in a profit or gain of $66,363.07. During the fiscal year of taxpayer commencing October 1, 1943, and ending September 30, 1944, taxpayer received from Snow on account of the purchase price of $90,000, the sum of $27,000, and elected pursuant to Section 44(b) of the Internal Revenue Code to report for income tax purposes the sale upon the installment basis. The real property was contiguous to the subdivision developed by taxpayer. The real property sold to Snow was acquired by the taxpayer as part of the 12,245 acres of land transferred to taxpayer as of January 1, 1926, in exchange for its common stock. This real property has been owned and held by taxpayer since that date, to wit: January 1, 1926. [R. 18-19, 61-62.]

The taxpayer corporation leased out for farming purposes that part of its land that was suitable therefor, throughout the years in question. It rented the property for farm purposes to realize what income it could, until

the land could be sold. In leasing its land for farming purposes, taxpayer reserved the right to enter the leased portion for the construction of roads, pipe lines and power lines. [R. 64, 67, 68.]

The taxpayer corporation also leased some portions of its land for quarrying rock and mining diatomaceous earth and realized royalties therefrom. The sale of decomposed granite was in such a manner that it would not interfere with the later subdivision of the property. The income from farming operations and from rock and earth royalties was insufficient to pay the county real estate taxes; and the taxes for the years 1935 to 1943, were unpaid at the date of the sale involved in this action. [R. 64-65.]

Taxpayer's affairs were handled by a managing vice-president, who rendered an annual report to the shareholders. The annual reports indicated that the only solution for taxpayer's financial difficulties was to sell its lands, as farming was unprofitable; and from the year 1935 to date the taxpayer attempted to and did sell all the property which could be sold. [R. 65.]

The taxpayer subdivided part of its land and offered the same for home sites and called the section "Rolling Hills"; and prior to the actual subdivision of this parcel within the meaning of state and county laws, the taxpayer sold portions of this section as acreage for residential purposes. [R. 65.]

Taxpayer caused to be distributed to the public certain leaflets or brochures describing the land it held. Some

of these brochures were confined to that section known as "Rolling Hills Subdivision," while other leaflets described the balance of the unsubdivided property of taxpayer known as "acreage." Leaflets and brochures relating to the whole ranch were distributed not earlier than the year 1937. In the year 1940, 10,000 postcards were mailed to the public in Los Angeles offering to sell land at $185 per acre. These cards referred to certain land on the northern periphery of the Rancho; however, taxpayer would have sold any other portion of its land that could have been made the subject of an advantageous sale. [R. 65-66.]

Between 1940 and 1944, the taxpayer made varied and vigorous efforts to dispose of all its real estate holdings to various agencies of the state and Federal Government and caused to be made plats showing the area laid out for park purposes. Between the period from September 30, 1939, to September 30, 1944, the sales of unsubdivided lands increased and outnumbered the sales of subdivided property. Taxpayer sold during the fiscal year ended September 30, 1944, both subdivided land and unsubdivided portions of its property, and sales of its unsubdivided portions greatly exceeded in number its subdivision sales. During the fiscal year ended September 30, 1944, the taxpayer in addition to the Snow sale made 34 other sales of unsubdivided land totaling 531.859 acres and reported these sales as ordinary income. [R. 66, 67.]

All sales of unsubdivided real property were subject to restrictions in the deed preventing use of the property except for residential purposes. [R. 67.]

Although taxpayer made 34 additional sales of unsubdivided property in the fiscal year ending September 30,

1944, which were reported as ordinary income, it has not at any time contended that this acreage represented a capital asset. [R. 67.]

The taxpayer was engaged in the real estate business. It was continuously engaged in the sale of its subdivided and unsubdivided portions of its property. The taxpayer was willing to sell all or any portion of its unsubdivided properties, that could be made the subject of an advantageous sale. The taxpayer in its corporation income and declared value excess profits tax return for the fiscal year ending September 30, 1944, stated that it was in the real estate business. [R. 67-68.]

On the basis of the foregoing facts, the District Court concluded that the parcel of land sold to Snow in July, 1944, was not a capital asset nor an asset used in taxpayer's trade or business, but was held primarily for sale to customers in the ordinary course of business. [R. 68.]

The District Court accordingly sustained the Commissioner's disallowance of the refund. From that conclusion the taxpayer has appealed to this Court. [R. 71.]

Summary of Argument.

The record shows that the acreage sold by taxpayer to Mrs. Snow in July, 1944 was neither a capital asset nor an asset used in taxpayer's trade or business, but was held primarily for sale to customers in the ordinary course of business. Whether property is held primarily for sale within the meaning of the capital gains provisions of the statute is essentially a question of fact. The frequency and continuity of sales have been held to be determining factors in deciding whether a taxpayer is engaged in a trade or business. It is unnecessary that real estate be

taxpayer's sole occupation, or that taxpayer itself engage in the occupation, since sales through agents satisfy the statutory requirements.

The legislative history of the capital gains provisions supports the Commissioner's treatment of the gain involved here as ordinary income rather than as capital gains.

An analysis of all facts shows that the District Court's findings are supported by the record. Taxpayer admitted in its tax returns that it was in the real estate business. It advertised all of its property for sale to the general public and engaged in continuous efforts to sell any property it could to anyone who would buy it. It engaged in the development of the area by building roads, having surveys made, putting in a water line, and plotting all its holdings on maps. Its other activities of leasing land for farming and mining purposes were incidental to the main purpose of selling real estate. The fact that it rented the property for farming pending its sale and that it received income from such rental does not make the property lose its character as an ordinary asset. Taxpayer publicized its holdings by mailing out thousands of circulars and brochures to the public generally. From its incorporation to the taxable year, its actual sales were frequent and continuous and in that year the sales of unsubdivided property outnumbered sales of subdivided land. It made no claim that any other sales were of land held as a capital asset.

Since the findings of the District Court are fully supported by the record and taxpayer has failed to show that they were clearly erroneous, the findings are conclusive and must be affirmed.

ARGUMENT.

The Evidence Amply Supports the District Court's Finding That Taxpayer Held the Property Sold to Snow Primarily for Sale to Customers in the Ordinary Course of Its Trade or Business.

A case of this character, which depends upon the application of Section 117(a)(1) and (j)(1), Internal Revenue Code, Appendix, *infra,* must turn upon its own facts in determining whether the property in question was held by the taxpayer primarily for sale to customers in the ordinary course of trade or business within the meaning of this section. The District Court found that the acreage sold by taxpayer to Mrs. Snow in July, 1944, was neither a capital asset nor an asset used in taxpayer's trade or business, but that it was held primarily for sale to customers in the ordinary course of business. [R. 68.] This conclusion is fully warranted by the law shown in cases previously decided by this Court as applied to the facts in the record.

A. Nature and Extent of Sales Activities.

This Court has consistently held that whether property is held by the taxpayer primarily for sale within the meaning of the capital gains provisions of the revenue laws is essentially a question of fact. *Rubino v. Commissioner,* 186 F. 2d 304, certiorari denied, 342 U. S. 814; *Field v. Commissioner,* 180 F. 2d 170; *Richards v. Commissioner,* 81 F. 2d 369; see also, *King v. Commissioner,* 189 F, 2d 122 (C. A. 5th), certiorari denied, 342 U. S. 829. In *Commissioner v. Boeing,* 106 F. 2d 305, 309, certiorari denied, 308 U. S. 619, this Court stated that—

> the facts necessary to create the status of one engaged in a "trade or business" revolve largely around

the frequency or continuity of the transactions claimed to result in a "business" status.

Ehrman v. Commissioner, 120 F. 2d 607 (C. A. 9th), certiorari denied, 314 U. S. 668; *Richards v. Commissioner, supra; Field v. Commissioner, supra.* Moreover, in the *Richards, Ehrman,* and *Boeing* cases, *supra,* this Court rejected the liquidation test in determining whether or not the taxpayer was carrying on a trade or business within the meaning of the capital gains provision of the statute. *Cf. Delsing v. United States,* 186 F. 2d 59 (C. A. 5th).

It is, of course, unnecessary that such activity be taxpayer's sole occupation or business, or that it occupy a majority of its time; and it may or may not be related to some other business activity of the taxpayer. *Harvey v. Commissioner,* 171 F. 2d 952 (C. A. 9th); see also, *King v. Commissioner, supra; Delsing v. United States, supra.* It is likewise unnecessary that taxpayer itself engage in the occupation or business, since sales through agents satisfy all requirements of the statute. *Ehrman v. Commissioner, supra; Brown v. Commissioner,* 143 F. 2d 468 (C. A. 5th); *Welch v. Solomon,* 99 F. 2d 41 (C. A. 9th).

B. Legislative History of Section 117.

The legislative history of the capital gains provisions discloses a congressional purpose to distinguish between property held for sale in the ordinary course of a trade or business and that which is not so held. It thus supports the Commissioner's treatment of the gains from the sale involved here as ordinary income and not capital gains, contrary to taxpayer's contention. (Br. 31-34.)

As this Court stated in *Rollingwood Corp. v. Commissioner,* 190 F. 2d 263, 266-267:

> The capital gains provisions are remedial provisions. Congress intended to alleviate the burden on a taxpayer whose property has increased in value over a long period of time from having the profits from sales taxed at graduated tax rates designed for a single year's income. The purpose is to protect "investment property" as distinguished from "stock in trade," or property bought and sold for profit. It is our view that this policy was not meant to apply to a situation where one of the essential purposes in holding the property is *sale.*

The difference between property *used* and property *held* in a trade or business is first noted in the change made in Section 117(a)(1) by the Revenue Act of 1938, c. 289, 52 Stat. 447. An exception was there added in order to permit taxpayers who had suffered losses on a sale (or on a forced disposition) of property *used* in a trade or business, as distinguished from that held therein, to offset such losses against business gains. The reason given in justification of the change was that gains and losses from the sale or other disposition of property used by the taxpayer in his trade or business were in reality business gains and losses, no less than gains or losses from the sale of property held by him for sale in the ordinary course of his trade or business. See H. Rep. No. 1860, 75th Cong., 3d Sess., pp. 17, 34 (1939—1 Cum. Bull. (Part 2), 728, 732-733, 752); and S. Rep. No. 1567, 75th Cong., 3d Sess., p. 7 (1939—1 Cum. Bull. (Part 2) 779, 783).

By 1942, however, Congress had become concerned with also relieving the taxpayer who had made gains on the sale of such property, *i. e.,* property used in connection with the taxpayer's trade or business. It was this concern which

caused Congress to enact Section 117(j) and thereby to relieve the taxpayer from the burden of the ordinary tax on gains derived from the sale of such property, unless the property was includible in his inventory, or was held by him primarily for sale in the ordinary course of his trade or business. At the same time, however, Congress wished to preserve the taxpayer's right to deduct his losses on such sales as ordinary losses. The device which it adopted to accomplish both results was to require the offsetting of such gains and losses against each other and to provide for the taxation of the gains, if they exceeded losses, at capital gain rates and the deduction of the losses from ordinary income, if these exceeded the gains. See H. Rep. No. 2333, 77th Cong., 2d Sess., pp. 53-54 (1942—2 Cum. Bull. 372, 415); and S. Rep. No. 1631, 77th Cong., 2d Sess., p. 50 (1942—2 Cum. Bull. 504, 545).

During the entire period of some thirty years in which the capital gains provisions have been in effect, the primary purpose of Congress in making the various exceptions, as well as the changes therein, was to insure that gain from the sale of property held for sale—and for nearly fifteen years also that used—in the course of the taxpayer's trade or business should be taxed at ordinary rates, and that only such property as was not so held or so used (except as provided in Section 117(j) with regard to the gain from the sale of property so used), be accorded the preferential capital gain and loss treatment. It follows that there is nothing inconsistent with the *use* of property for farming and at the same time holding it for sale. This is made clear by the terms of the statute itself; for it provides that certain property used by the taxpayer in a trade or business shall be treated as a capital asset, but only such property "which is not" held primarily for sale.

C. The Facts Sustain the District Court's Findings.

The taxpayer corporation was organized for the purpose, among others, of buying, selling, and developing real property [R. 90] and it continuously engaged in the real estate business from the time of its incorporation. [R. 68, 178.] It acquired the entire Rancho Palos Verdes tract in order to sell to persons who were willing to purchase any part of the property. In its corporation income and declared value excess profits tax returns for the fiscal year ended September 30, 1944, the year in which the sale to Mrs. Snow was made, taxpayer gave its business as real estate. [R. 67.] This admission lends strong support to the District Court's conclusion that taxpayer was engaged in the real estate business. *White v. Commissioner,* 172 F. 2d 629 (C. A. 5th); *Oliver v. Commissioner,* 138 F. 2d 910 (C. A. 4th).

There is ample evidence to support the District Court's finding that taxpayer advertised all of its property for sale to the general public and was willing at all times to sell portions of its unsubdivided realty. [R. 68.] Mr. Benedict, chairman of taxpayer's board of directors, testified that Mr. Hanson, vice-president and general manager of taxpayer corporation who was also a licensed real estate broker, first made vigorous and continuous efforts to sell the tract as a whole; that Mr. Hanson was paid commissions on sales, and had an office on the property. [R. 97, 104, 106.] He further testified that the corporation attempted to sell any property it could from 1934 to 1941 in order to pay its taxes [R. 107, 142], and he said, referring to the year 1939, "We were trying to sell property to anyone who would buy it. * * *." [R. 117.]

Taxpayer's development of the tract was not confined to the Rolling Hills subdivided area, which taxpayer seeks to

separate from its other real estate properties. (Br. 27, 30.) There were roads put through other parts of the tract [R. 95, 125, 132, 158]; surveys were made in connection with sales of other areas [R. 125, 172]; substantially all holdings of the taxpayer corporation were plotted on maps [R. 144]; and a water line was put in which went through other portions of the tract [R. 149-150, 169.]

Contrary to taxpayer's contention (Br. 29-30), taxpayer's principal occupation was not farming, or any other activity but real estate. The general manager's report for September 30, 1936, stated that sales of decomposed granite were being made in such a way that they would not interfere with later subdivision of the property. [Ex. D, R. 116.] In the report for 1935 it was stated that the taxpayer was in the process of publicizing its holdings. [R. 115, 125.] In the 1937 report, the statement was made that the lands were unprofitable to farm and that the salvation of the corporation was to sell fine residential property rather than to engage in farming. [R. 125-126.] The 1938 report stated that taxpayer's future was dependent on successful development and sales of its land, and that "Every effort will be made to increase sales during the coming year." [R. 129.] In 1939, the report gave an account of a sale for a Navy housing project, and stated other attempts were being made to sell adjacent property for the same purposes. It stated further [R. 130-131]:

> As repeatedly stressed in these annual reports, the management believes that the future of the Corporation lies in successfully disposing of the real estate, either in large blocks or in small home sites or to speculators, and in being ready to take advantage of

> the real estate cycles, disposing of as much property as it can during the periods of prosperity, as it is not possible to work the land profitably from a farming standpoint.

In 1940 the report stated again that the real estate business of the corporation was the only profitable enterprise it had. It said [R. 135]:

> The corporation is going to be dependent in its survival upon its development of real estate and natural resources. Our natural resources cannot be counted on as a staple income because they are being constantly depleted. Therefore, real estate is our all important merchandise. The only real estate that we have is for residential purposes as the trend at this time is for real estate for use and not for speculation. Broadly speaking, there are two residential uses for our property. One is for year around homes and the other is for week-end places and hobby ranches. The latter are luxuries.
>
> * * * * * *
>
> We have tried for months to sell this land for $300 an acre to speculative builders.

That the public was solicited to buy land, both subdivided and unsubdivided, is clearly shown by the record, in spite of taxpayer's contentions to the contrary. (Br. 27.) The report for 1940 [Ex. H] stated taxpayer had recently mailed out 10,000 postcard circulars offering acreage at $185 per acre. [R. 136.] Brochures were sent out to the general public [see Govt. Exs. A, A-1, A-2, A-3, A-4] during the years 1937, 1940, 1944, and 1945, some of which referred not only to the Rolling Hills subdivision, but in their text specifically made reference

to the entire property held by taxpayer. [R. 108-110, 119.]

The actual sales made by taxpayer were frequent and continuous. Even before the formation of the taxpayer corporation there had been separate acreage parcels sold by the syndicate out of the Rancho Palos Verdes. [R. 92.] These sales activities continued frequently and continuously down to the taxable year. [R. 94.] Mr. Vanderlip, the president of the taxpayer corporation, testified as to sales to members of the corporation, and to other sales in 1938, 1939, 1940, 1941, and in subsequent years down to 1944. The general manager's report for 1935 tabulated the profit from land sales from 1926 to that year, which ranged from $4,000 to over $300,000 per year except for 1932, and the subsequent reports listed a profit of approximately $10,500 in 1936; $44,500 in 1938, $22,271.01 (gross) in 1940; and $50,000 in 1941. [R. 124, 129, 137, Ex. D.]

The number of sales from 1939 to 1944 of both acreage and subdivided property with the number of acres involved and the selling price are tabulated in Exhibit 7, incorporated in the stipulation of facts. [R. 19, 46.] From 1939 to 1944 sales of unsubdivided lands increased and outnumbered sales of subdivided property. The frequency and continuity of these sales is thus clearly apparent. During 1944, the year in which the sale was made to Mrs. Snow, there were 35 acreage sales of a total of 954 acres, at $250,500, as against 18 sales of subdivided property, of a total of 154 acres, at a total selling price of $55,000. Although Mr. Vanderlip testified the corporation had made an error [R. 179] up to the time of this action the taxpayer corporation had made no claim

that any other sales than the one to Mrs. Snow were of land held as a capital asset [R. 67].

From these facts, it is clear that the sales were not casual sales of real estate held for investment as claimed by taxpayer. (Br. 35.) It is also clear that, contrary to taxpayer's contention (Br. 40), there was development of the property and substantial sales activity, so that no exception exists under the facts hereto the frequency of sales test, as previously enunciated by this Court. *Commissioner v. Boeing, supra.* The liquidation test contended for by taxpayer (Br. 35-37) was rejected by this Court in *Ehrman v. Commissioner, supra.* Moreover, the evidence here does not support the contention that taxpayer was merely a passive investor. (Br. 41.) The fact that sales were made through agents [R. 104, 108] does not detract from the taxpayer's status of being engaged in the real estate business. *Ehrman v. Commissioner, supra; Brown v. Commissioner, supra.*

The record completely refutes taxpayer's contention that the parcel sold to Mrs. Snow was a Section 117(j) asset because farming was taxpayer's trade or business. The taxpayer rented its tillable property for farm purposes only in order to realize what income it could until the land could be sold. [R. 68.] In leasing its land for farm purposes, taxpayer reserved the right to enter the leased portions for the construction of roads, pipe lines, and power lines. [R. 67, 176.] The portions of the reports previously referred to disclose that farming was considered an unprofitable venture, and that the sale of

real estate was taxpayer's real business. The leasing of land for farming, as well as for mining, oil drilling, and other purposes, was incidental to taxpayer's primary business of selling real estate. It has been held that property such as this which was acquired and held for primary purposes of sale does not lose its character as an ordinary asset even though pending the sale it is rented out and yields income. *Rollingwood Corp. v. Commissioner, supra; Kings v. Commissioner, supra.*

The fact that the particular parcel sold to Mrs. Snow had been held by taxpayer for 18½ years before sale (Br. 31) is of no significance. Regulations 111, Section 29.117-1, Appendix, *infra,* specifically say, "In determining whether property is a 'capital asset,' the period for which held is immaterial."

The cases on which taxpayer relies are all distinguishable on their facts, and need not be discussed in detail. The case of *Phipps v. Commissioner,* 54 F. 2d 469 (C. A. 2d) (Br. 35, 40), is distinguishable since in that case there was found to be no development or sales activity which the record here clearly shows to exist. *Guthrie v. Jones,* 72 F. Supp. 784 (W. D. Okla.), appeal dismissed, 163 F. 2d 1018 (C. A. 10th) (Br. 37-38), is distinguishable from the instant situation inasmuch as in the *Guthrie* case taxpayer was in the loan and investment business, had never been in the real estate business, had never solicited or promoted sales, and made only an occasional sale.

D. The Findings of the District Court are Supported by the Record and Therefore Must Be Affirmed.

The findings of the District Court are conclusive inasmuch as they are fully supported by the record. Taxpayer has failed to show that the findings were clearly erroneous, and in the absence of such a showing they should not be set aside by this Court. Rule 52(a), Federal Rules of Civil Procedure; *Rollingwood Corp. v. Commissioner, supra; Lerner Stores Corp. v. Lerner,* 162 F. 2d 160 (C. A. 9th); *Lincoln Nat. Life Ins. Co. v. Mathisen,* 150 F. 2d 292 (C. A. 9th); *Wingate v. Bercut,* 146 F. 2d 725 (C. A. 9th).

Conclusion.

The decision of the District Court was correct and should be affirmed.

Respectfully submitted,

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March, 1952.

APPENDIX.

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(26 U. S. C. 1946 ed., Sec. 22.)

SEC. 44. INSTALLMENT BASIS.

* * * * * * * *

(b) *Sales of Realty and Casual Sales of Personalty.*—In the case * * * (2) of a sale or other disposition of real property, if in either case the initial payments do not exceed 30 per centum of the selling price (or, in case the sale or other disposition was in a taxable year beginning prior to January 1, 1934, the percentage of the selling price prescribed in the law applicable to such year), the income may, under regulations prescribed by the Commissioner with the approval of the Secretary, be returned on the basis and in the manner above prescribed in this section. As used in this section the term "initial payments" mean the payments received in cash or property other than evidences of indebtedness of the purchaser

during the taxable period in which the sale or other disposition is made.

* * * * * * * *

(26 U. S. C. 1946 ed., Sec. 44.)

SEC. 117 [As amended by Sections 150 and 151 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter—

(1) *Capital Assets.*—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade of business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, or property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23 (l), or real property used in the trade or business of the taxpayer.

* * * * * * * *

(4) *Long-term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 6 months, if and to the extent such gain is taken into account in computing net income;

* * * * * * * *

(8) *Net Long-term Capital Gain.*—The term "net long-term capital gain" means the excess of long-term capital

gains for the taxable year over the long-term capital losses for such year;

* * * * * * * *

(10) *Net Capital Gain.*—

(A) *Corporations.*—In the case of a corporation, the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges; and

* * * * * * * *

(c) *Alternative Taxes.*—

(1) *Corporations.*—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, there shall be levied, collected, and paid, in lieu of the tax imposed by sections 13, 14, 15, 204, 207 (a) (1) or (3), and 500, a tax determined as follows, if and only if such tax is less than the tax imposed by such sections:

A partial tax shall first be computed upon the net income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and the total tax shall be the partial tax plus 25 per centum of such excess.

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(j) *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of Property Used in the Trade or Business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used

in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than 6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion * * * of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, or conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

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(26 U. S. C. 1946 ed., Sec. 117.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.117-1. *Meaning of terms.*—The term "capital assets" includes all classes of property not specifically excluded by section 117(a)(1). In determining whether property is a "capital asset," the period for which held is immaterial.

The exclusion from the term "capital assets" of property used in the trade or business of a taxpayer of a character which is subject to the allowance for depreciation provided in section 23(l) and of real property used in the trade or business of a taxpayer is limited to such property used by the taxpayer in the trade or business at the time of the sale, exchange, or involuntary conversion. Gains and losses from the sale or exchange of such property are not subject to the percentage provisions of section 117(b) and losses from such transactions are not subject to the limitaitons on losses provided in section 117(d), except that under section 117(j) the gains and losses from the sale or exchange of such property held for more than 6 months may be treated as gains and losses from the sale or exchange of capital assets, and may thus be subject to such limitations. See section 29.117-7. Property held for the production of income, but not used in a trade or business of the taxpayer, is not excluded from the term "capital assets" even though depreciation may have been allowed with respect to such property under section 23 (l) prior to its amendment by the Revenue Act of 1942. However, gain or loss upon the sale or exchange of land held by a taxpayer primarily for sale to customers in the ordinary course of his business, as in the case of a dealer in real estate, is not subject

to the limitations of section 117(b), (c), and (d). The term "ordinary net income" as used in these regulations for the purposes of section 117 means net income exclusive of gains and losses from the sale or exchange of capital assets.

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Section 117(a)(10) defines "net capital gain." In the case of a corporation the term "net capital gain" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges which losses include any amounts brought forward pursuant to section 117(e).

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SEC. 29.117-7 [As amended by T. D. 5394 (1944 Cum. Bull. 274)]. *Gains and losses from involuntary conversions and from the sale or exchange of certain property used in the trade or business.*—Section 117(j) provides that the recognized gains and losses

(a) from the sale, exchange, or involuntary conversion of property used in the trade or business of the taxpayer at the time of the sale, exchange, or involuntary conversion, held for more than six months, which is

(1) of a character subject to the allowance for depreciation provided in section 23(l), or

(2) real property,

provided that such property is not of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or is not held by the taxpayer primarily for sale to customers in the ordinary course of trade or business, and

(b) from the involuntary conversion of capital assets held for more than six months, and

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shall be treated as gains and losses from the sale or exchange of capital assets held for more than six months if the aggregate of such gains exceeds the aggregate of such losses. If the aggregate of such gains does not exceed the aggregate of such losses, such gains and losses shall not be treated as gains and losses from the sale or exchange of capital assets.

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Section 117(j) does not apply to gains and losses on the sale, exchange, or involuntary conversion of any property which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or which is held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business, * * *